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No. 194

IN THE

Supreme Court of the United States

OCTOBER TERM, 1960

PAUL F. MYERS, ET AL.,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT.

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Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT.

To: The Honorable Earl Warren, Chief Justice of the United States, and to the Associate Justices of the Supreme Court of the United States:

The undersigned, on behalf of the petitioners herein, prays that a writ of certiorari issue to review the final order and judgment of the United States Court of Appeals for the Sixth Circuit, entered in cases numbered, 14,276, Paul F. Myers and Dora Jane Myers v. Commissioner of Internal Revenue, and 14,277, Estate of Charles W. Myers, Deceased, Paul F. Myers, Administrator, and Blanche C. Myers, v. Commissioner of Internal Revenue, which had been consolidated therein for their review by the stipulation of the attorneys for the parties.

OPINIONS BELOW

The opinion of Judge Norman O. Tietjens of the Tax Court of the United States, (T. C. Memo. 1959-231, December 11, 1959), is in the appendix hereto, pages 15 to 19.

The Order of the Court of Appeals dated February 22, 1961, is reported in 287 F. 2nd, p. 400, and is in the appendix hereto, page 14 .

JURISDICTION

Petitioners seek to have reviewed the order of the United States Court of Appeals for the Sixth Circuit, dated and filed on February 22, 1961, which affirmed the determination of the Tax Court of the United States in these cases by Memorandum Opinion (T. C. Memo. 1959-231) dated December 11, 1959.

Upon application therefor, an order was entered herein by Mr. Justice Potter Stewart on May 22, 1961, extending the time for filing petition for writ of certiorari to, and including July 3, 1961.

The jurisdiction of this Court is invoked under 28 U. S. Code 1264 (1).

QUESTIONS PRESENTED

1. As stated in the memorandum opinion of the Tax Court, the parties agreed upon all facts leaving only a question of law for decision in these cases, namely, whether the gain realized by petitioners upon repossession of real estate in 1954 under an executory sale contract is taxable as ordinary income or long term capital gain.

The decision of the Tax Court on this question, against the petitioners, held, in effect, that there was no sale, thus making it necessary to consider in the Court of Appeals the further question of law and fact, namely,

2. Did the dealings between the petitioners (vendors) and the purchaser, whereby the petitioners, while retaining title until the purchase price was fully paid, surrendered possession of the real estate at the time the purchaser made the down payment and assumed the other responsibilities of ownership, such as liability for interest on the unpaid purchase money, taxes, insurance and repairs, amount to a sale for federal income tax purposes.

STATUTE AND REGULATION INVOLVED

Reference has been made in the argument to the definition in Subsection (a) (4) of Sec. 117 of the Internal Revenue Code of 1939, as amended, (26 U. S. Code, 1952 ed., Sec. 117) which defines long term capital gain to "mean gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing gross income."

Reference is also made herein to Sec. 39.44-4(b) of Regutions 118, formulated to implement Sec. 44 I. R. C., 1939 (26 U. S. Code, 1952 ed., Sec. 44) which provides a formula for computing gain or loss upon repossession in a deferred payment sale of real property not on installment plan, the pertinent part of which Section is as follows:

> If the vendor has retained title to the property and the purchaser defaults in any of his payments, and the vendor repossesses the property, the difference between (1) the entire amount of the payments actually received on the contract and retained by the vendor plus the fair market value at the time of repossession of fixed improvements placed on the property by the purchaser and (2) the sum of the profits previously returned as income in connection therewith and an amount representing what would have been a proper adjustment for exhaustion, wear and tear, obsolescence, amortization, and depletion of the property during the period the property was in the hands of the purchaser had the sale not been made,

will constitute gain or loss, as the case may be, to the vendor for the year in which the property is repossessed." * * *

STATEMENT OF FACTS

The facts in petitioners cases arise from admissions in the pleadings, facts agreed upon in the stipulation, and facts found in the memorandum opinion of the Tax Court. They may be summarized as follows:

Charles W. Myers and Paul F. Myers, who were father and son, owned four tracts of land as tenants in common in Waverly, Ohio. The premises were improved prior to January 1, 1952, by a cinder block building, in which their garage business was operated.

Title to an adjacent tract of land was held by Paul F. Myers and his wife, Dora Jane Myers, as tenants in common.

The five tracts of land cost a total of $8,000 in 1949 and the improvements consisting of the cinder block building cost $6,000. In October of 1952 the property together with the improvements had an adjusted basis of $12,895, representing the original cost of $14,000 less depreciation allowed by the commissioner of $1,105.

On October 29, 1952, Charles, Paul and Dora Jane Myers by written land contract agreed to sell the above depreciable improved real estate to F. R. L. Realty Corporation for $50,000.00, $5,000 down and the balance of the purchase money to be paid in semi-annual installments of $1,250 each, with interest at 5%. The purchaser assumed the payment of taxes, insurance, and the cost of upkeep of the property. The possession of the property was surrendered to the purchaser upon execution of the contract. No provisions were contained in the contract for contingencies in case of default.

The following payments were made by the F. R. L. Realty Corporation under the contract:

Date	Payments	Interest
October 1952—down payment	$5,000.00	
April 1953	1,250.00	$1,124.00
October 1953	1,250.00	1,092.74
April 1954	1,250.00	1,060.20
Total	$8,750.00	$3,276.94

In October of 1954 the F. R. L. Realty Corporation defaulted in its payment. Charles, Paul and Dora Myers agreed to take back their property and terminate the contract. The F. R. L. Realty Corporation surrendered the premises and the Myerses repossessed the property in December of 1954. During the period when the realty corporation was in possession, the property depreciated to the extent of $780 and no improvements were made to the property.

The Commissioner in 1957 and 1958 made deficiency assessments against petitioners claiming that they realized long term capital gain in 1952 from the deferred payment sale of capital assets that year and that payments on the principal in 1953 and 1954 were taxable in those years as ordinary income, and that the gain on repossession in 1954 was taxable as ordinary income. Petitioners filed four cases in the Tax Court to redetermine the tax deficiencies. During the pendency of the proceedings in the Tax Court, the Commissioner conceded that the payments of purchase money in 1952, 1953 and 1954 were not taxable as the petitioners had not recovered their basis in the property. Petitioners' two cases involving gain on the repossession were appealed to the United States Court of Appeals for the Sixth Circuit following the decision

of Judge Tietjens of the Tax Court that the gain on repossession was taxable as ordinary income. The Court of Appeals affirmed the decision of the Tax Court.

REASONS FOR THE ALLOWANCE OF THE WRIT

1. The decision herein of the United States Court of Appeals for the Sixth Circuit affirming the decision of the Tax Court of the United States, on the principal question in our case, namely whether petitioners' gain or repossession is long term capital gain or ordinary income, is in conflict with the decision of this Court in the case of *Arrowsmith v. Commissioner*, 344 U. S., 6, which holds that there is a relation back to the nature of the assets involved in a transaction of an earlier year to determine the character of gain or loss, whether capital or not, when income received in a later tax year flows from the original transaction. The petitioners contend that the gain on repossession in 1954 is the wind-up of a sale of capital assets entered into in 1952, and is therefore entitled to long term capital gain treatment.

2. The decision herein as to the secondary question, whether or not a sale was effected between petitioners and the purchaser under the land contract, is at variance with the language in the decision of the Court of Appeals for the Sixth Circuit in the case, *In re Segall*, 114 F., 2d, 706, and conflicts with the decision in the case of *Commissioner of Internal Revenue v. Union Pacific R. Co.*, 86 F. 2d, 637, (2d Circuit) and the case of *Trust Co. v. Bouse*, 163 Ohio St., 392, 127 N. E., 2d, a leading case which states the substantive law of the State of Ohio defining the property rights of the parties to such a land contract.

ARGUMENT

The land contract entered into in 1952 between the taxpayers and the F. R. L. Realty Corporation, is a well known commercial transaction in common use in most of the states. It is used in Ohio and other states in the midwest extensively where real estate is sold for a small down payment. Title is retained by the vendor under such contracts until full payment of the purchase money is made, or in many cases, until a substantial part of the purchase price is paid when title is then transferred to the purchaser and a real estate mortgage taken back for the balance due.

When the parties enter into such a contract, two things can happen. Either the purchase price is paid and the contract is completed by transfer of title, or there is a default and the vendor repossesses the real property which was the subject of the contract.

The tax laws make provisions for either contingency. Unless the down payment of purchase money exceeded, or was equal to the vendor's adjusted basis in the property, no taxable gain results. When the payments equal the basis, then there is taxable income. The gain when received would be captial gain or ordinary income depending whether the assets sold were capital assets or non-capital assets.

If the purchaser defaulted, Sec. 39.44-4b provided for gain on the repossession. The purchase money retained by the vendor plus the value of improvements erected by the purchaser, less the amount of payments reported for taxation and an amount allowable for depreciation while the premises were in possession of the purchaser, represent the taxable gain on the repossession.

We look upon the tax on such a deferred payment sale as a "delayed action" tax. The outcome must be awaited to see if there is gain on the sale or gain on repossession.

Whether the purchaser completed his contract or defaulted in the performance of it, the character of the real estate as capital assets or non-capital assets would not be changed. We submit that if there had been gain in the payments of purchase money received in this case, it would have been taxed under Sec. 117 of the Internal Revenue Code of 1939, (26 U. S. Code 1952 ed. Sec. 117) above referred to, as long term capital gain since the depreciable real estate sold was capital assets and had been owned by the taxpayers for more than six months. Like treatment should be accorded the same proceeds if the purchaser fell into default and the purchase money payments were taxed as gain on repossession under the formula in Sec. 39.44-4b of Regulations 118.

Under Sec. 117 (a) (4) of the Internal Revenue Code of 1939, as amended (26 U. S. Code, 1952 ed., Sec. 117), long term capital gain results from the sale or exchange of depreciable real estate (capital assets), if the asset had been held for more than six months. This law was reenacted in 1954, (Sec. 1222 of the Internal Revenue Code of 1954, 26 U. S. Code, 1958 ed., Sec. 1222) and is a part of today's tax laws.

The injudicious value given to the case of *Ralph A. Boatman*, 32 T. C., 1188, as a precedent in the memorandum opinion (T. C. Memo. 1959-231) of the Tax Court deciding these cases, denies to petitioners the favorable treatment of the gain on repossession which they claim relates back to a sale of capital assets—the land-contract transaction in which they had surrendered possession, and other attributes of ownership to the purchaser, of certain de-

preciable real estate held for more than six months before the land contract was executed. An examination of the *Boatman* case discloses that it can be distinguished on the facts. The transaction there between the seller and buyer was but a contract to sell in the future—it was not a closed transaction for tax purposes. The possession of the property to be sold was not surrendered to the purchaser and the purchaser had not been clothed with the other benefits and burdens of ownership.

The Tax Court failed to give consideration to facts in the *Myers* cases which are important taxwise. Possession was given to the purchaser and the purchaser assumed to pay interest on the balance of the purchase price; taxes; insurance; and be responsible for repairs. In executory contract sales, the passage of title is perhaps the most conclusive circumstance in the determination of when a real estate transaction is closed—but not always. Transfer of possession is also significant. Another important factor is whether there has been a substantial performance of conditions such as would impose upon the purchaser an unconditional duty to pay. Usually a sale will be considered complete when the buyer is put in possession and clothed with all the benefits and burdens of ownership, even though delivery of the deed is postponed until the purchase money is fully paid.

The Ohio rule with regard to the relationship existing between the seller and the purchaser under such an executory land-contract is stated in the Supreme Court case of *Trust Co. v. Bouse*, 163 Ohio St., 392 (1955), that because of "the well known fundamental rule in equity, what is agreed to be done is regarded as done, so that from the time a contract is made for the purchase of real estate, the vendor is, in a sense, a trustee for the purchaser, and

the purchaser, in a sense, is the real owner of the land, so that each under the ordinary equitable rules is protected. The whole practice in equity with reference to such contract is clearly on the basis that the parties are under equitable obligations to each other."

The Federal rule follows the Ohio rule. In the case of *Commissioner of Internal Revenue v. Union Pacific R. Co.*, (C. C. 2), 86 F., 2d, 637, we find the following statement of law, "A closed transaction for tax purposes results from a contract of sale which is absolute and unconditional on the part of the seller to deliver to the buyer a deed upon payment of the consideration and by which the purchaser secures immediate possession and exercises all of the rights of ownership. The delivery of a deed may be postponed and payment of a part of the purchase money may be deferred by installment payments; but for taxing purposes, it is enough if the vendor obtains under the contract the unqualified right to recover the consideration."

In the case of *Commissioner of Internal Revenue v. Segall*, 114 F., 2d, 706, *in the Sixth Circuit*, the Court in discussing the case, recognized that there are no hard and fast rules for determining for tax purposes, when a sale was consummated, and no single factor is controlling, but the transaction must be viewed as a whole and in the light of realism and practicality, citing a number of cases where transfer of possession and where the performance of conditions precedent imposed upon the purchaser an unconditional duty to pay, were considered to be factors in determining whether or not a sale was effected.

We therefore submit that as a matter of law, the executory land contract between petitioners and their purchaser effected a sale of depreciable property (capital assets) and that the profits, if any, from such sale are entitled to long term capital gain treatment.

It is felt that both the Tax Court and the Court of Appels were impressed by the facts that the petitioners, upon repossession, recovered the real estate which had been sold and also retained the purchase money which had been paid. The Tax Court opinion says, in paraphrasing the language used in the *Boatmen case*, "(They) merely entered into a sale contract which was never carried out—a transaction which left (them) with the subject of the contract plus ($8750)."

Judge Thornton in the order entered in the Court of Appeals, says: "The determination of the Tax Court that the petitioners realized ordinary income in 1954 when they repossessed real estate (which they had sold in 1952 after owning the same for more than six months) under mutual agreement with the vendee that the sale was not to be carried out, and that they were to retain that part of the purchase price which had already been paid to them, is affirmed * * *."

What may seem to be unjust enrichment is, under the tax laws, only a factor in determining gain on repossession. Unless there is a repossession of the real estate sold and a concurrent retention of the purchase money paid (and not reported as taxable income) there is no taxable gain on repossession. Sec. 39.44-4b of Regulations 118, as we have pointed out above, provides that the difference (1) between the payments *retained* by the vendor plus the fair market value of improvements placed on the property by the purchaser, and (2) the sum of profits previously returned as taxable income plus a reasonable allowance for depreciation (fixed in these cases at $780.00), constitutes gain or loss to the vendor for the year in which the property is repossessed. It does not follow that the gain is ordinary income and the Regulations do not make it so.

We pointed out to the Tax Court that our contention was supported by the following named text book writers, and editorial boards of tax services: Rabkin and Johnson (Sec. 43.12) in their text, Federal Income, Gift and Estate Taxation; Alexander Federal Tax Handbook, 1954, Par. 1313, page 263; Monatt's Tax Atlas, 1956, Par. 15,030; Commerce Clearing House, Standard Federal Tax Reporter, 1954, Vol. 2, Par. 430.63; and, Prentice-Hall, Federal Tax Guide, 1956, at Par. 67.13. This view stems from the *Arrowsmith* case in this Court (*Arrowsmith v. Commissioner*, 344 U. S. 6, 97 L. ed. 6, 73 S. Ct. 713). It was there held that a loss arising in 1944 from a capital transaction in 1940, and which would have been a capital loss if it had materialized then, was entitled to "capital loss" treatment for tax purposes in 1944. Two stockholders liquidated and divided the proceeds of a corporation owned by them, the final distribution being made in 1940. In 1944 a judgment was rendered against the corporation and one of the stockholders, half of which was paid by each stockholder. In his opinion, Mr. Justice Black stated, "The losses here fall squarely within the definition of capital losses." * * * It is not even denied that had this judgment been paid after liquidation, but during the year 1940, the losses would have properly been treated as capital ones. For payment during 1940 would simply have reduced the amount of capital gains taxpayers received during that year.

CONCLUSION

The Court of Appeals in affirming the decision of the Tax Court of the United States did not give consideration and weight to the holding of this Court in the case of *Arrowsmith v. Commissioner*, 344 U. S., 6, which petitioners believe is decisive of the question of law in their cases. Instead, the decision of the Tax Court of the United States was based upon the holding in a Tax Court case, *Boatman v. Commissioner* 32 T. C., 118, in which the Court discovered an illusional similarity between the facts and law there and the facts and law in petitioners' cases.

Therefore, petitioners request that a Writ of Certiorari be granted.

Respectfully submitted,

CHARLES H. SMITH,
Attorney for petitioners.

United States Court of Appeals
For The Sixth Circuit

No. 14276—Paul F. Myers and Dora Jane Myers, Petitioners v. Commissioner of Internal Revenue, Respondent

No. 14277—Estate of Charles W. Myers, Deceased, Paul F. Myers, Administrator, and Blanche C. Myers, Petitioners v. Commissioner of Internal Revenue, Respondent

Order

[Filed February 22, 1961]

Before: Simons, Senior Judge, O'Sullivan, Circuit Judge, and Thornton, District Judge.

The above cause coming on to be heard on the record, the briefs of the parties, and the argument of counsel in open court, and the court being duly advised,

The determination of the Tax Court that the petitioners realized ordinary income in 1954 when they repossessed real estate (which they had sold in 1952 after owning the same for more than six months) under mutual agreement with the vendee that the contract of sale was not to be carried out, and that they were to retain that part of the purchase price which had already been paid them, is affirmed upon the opinion of Judge Norman O. Tietjens of the Tax Court of the United States. (T. C. Memo. 1959-231, December 11, 1959)

Approved for entry:

s Thomas P. Thornton

United States District Judge, (sitting by designation)

(Reported in 287 F. 2d 400)

Memorandum Opinion of the Tax Court

(T. C. Memo. 1959-231) entered December 11, 1959

Tietjens, *Judge*: The Commissioner determined the following deficiencies in income tax and additions to tax:

Docket Number	Petitioners	Years	Income Tax	Additions to Tax I.R.C. of 1939 Sec. 293 (a)	Sec. 294(d) (1)(A)	Sec. 294(d) (2)
66948	Estate of Charles W. Myers, Dec'd, Paul F. Myers, Administrator, and Blanche C. Myers	1952	$402.00	$20.10	$46.62	$31.08
		1953	75.00	3.75	10.91	7.26
66949	Paul F. Myers and Dora Jane Myers	1954	582.26	.....	.....	.....
66955	Paul F. Myers	1952	248.02	12.40	22.07	14.70
		1953	567.87	28.39	.....	.....
				Sec. 6651(a), I.R.C. 1954		
72557	Estate of Charles W. Myers, Dec'd, Paul F. Myers, Administrator, and Blanche C. Myers	1954	$464.00	.....	$46.40	.....

The only question for decision is whether gain realized by petitioners upon the repossession of real estate under an executory sale contract in 1954 is taxable as ordinary income or as capital gain.

The propriety of the additions to tax depends upon whether or not resolution of the principal issue results in deficiencies in income tax.

All of the facts have been stipulated, are so found, and the stipulation of facts in the attached exhibits are included herein by this reference.

Charles W. Myers and Paul F. Myers, who were father and son, owned four tracts of land as tenants in common in Waverly, Ohio. The premises were improved prior to January 1, 1952, by a cinder block building, in which a garage business was operated.

Title to an adjacent tract of land was held by Paul F. Myers and his wife, Dora Jane Myers, as tenants in common.

The five tracts of land cost a total of $8,000 in 1949 and the improvements consisting of the cinder block building cost $6,000. In October of 1952 the property together with the improvements had an adjusted basis of $12,895, representing the original cost of $14,000 less depreciation allowed or allowable of $1,105.

In August of 1952 the United States Atomic Energy Commission announced that a site near Waverly, Ohio, had been selected for the construction of a gaseous diffusion plant. Following the announcement, builders, promoters, speculators and workers came from all parts of the country to build houses, trailer parks, motels, restaurants and establish other businesses to serve the incoming construction workers. The F. R. L. Realty Corporation obtained a lease on a store building adjoining the Myers Garage. The corporation soon became interested in the garage property and a contract was drawn up wherein it offered to pay Charles W. Myers, Paul F. Myers and Dora Jane Myers $50,000 for the property. The contract called for the payment of $5,000 down and $2,500 a year, payable semi-annually, with interest at 6 per cent upon the unpaid balance.

On October 29, 1952, Charles, Paul and Dora Jane Myers by written agreement agreed to sell the above described real estate to F. R. L. Realty Corporation for $50,000. The contract recited that $5,000 had been paid. The balance

was to be paid at the rate of $2,500 per annum, payable semi-annually with 5 per cent interest. No provisions were contained in the contract for contingencies in case of default.

The following payments were made by the F. R. L. Realty Corporation under the contract:

Date	Payments	Interest
October 1952 - down payment	$5,000.00	
April 1953	1,250.00	$1,124.00
October 1953	1,250.00	1,092.74
April 1954	1,250.00	1,060.20
Total	$8,750.00	$3,276.94

In October of 1954 the F. R. L. Realty Corporation defaulted in its payment. Charles, Paul and Dora Myers agreed to take back their property and terminate the contract. The F. R. L. Realty Corporation surrendered the premises and the Myerses repossessed the property in December of 1954. During the period when the realty corporation was in possession, the property depreciated to the extent of $780 and no improvements were made to the property.

Paul Myers did not report any gain or interest income from the foregoing transaction in his returns for the years 1952 and 1953. Charles and Blanche C. Myers did not report any gain or interest from the transaction in their original 1952 return. A gain was reported in their amended return for the year 1952 and delinquent returns for the years 1953 and 1954 which were filed on about May 18, 1955.

The Commissioner determined that petitioners realized long-term capital gains in 1952 from the execution of the contract in that year and that payments on the original principal received in 1953 were taxable in that year as ordinary income. He now concedes these determinations

to be in error. He maintains, however, that petitioners realized gain in 1954 upon repossession of the real estate taxable as ordinary income in the amount of $8,750 less depreciation of $780.

Petitioners contend that their gain is a capital gain. They cite no cases which would sustain their contention and this case is referred to on brief as "a question of first impression."

Since the briefs were filed, however, the case of *Ralph A. Boatman*, 32 T. C. .... (September 14, 1959) has been decided by this Court. There, petitioner was the vendor of a farm under an executory sale contract. The selling price was $60,000, of which $12,000 was paid on execution of the contract, the balance to be paid on subsequent delivery of the deed. The contract was not carried out and the petitioner retained the $12,000. We held this amount to be taxable to petitioner as ordinary income.

We perceive no controlling factual differences between the *Boatman* case and the one before us. There we held that there had been no "sale or exchange," and to paraphrase language used in the Boatman opinion,

> The facts were all stipulated and it is abundantly clear that no sale was ever made by petitioner(s). (They) merely entered into a sale contract which was never carried out—a transaction which left (them) with the subject of the contract plus ($8,750).
>
> * * * The fact remains petitioner(s) never sold or exchanged anything that resulted in (their) receiving the ($8,750).
>
> We hold, therefore, that the amount of ($8,750 less depreciation) was retained by the petitioner(s) when the executory contract for the sale of (the real estate) was not carried out, is taxable to (them) as ordinary income. * * *

On the principal issue we decide in this case on the authority of *Ralph A. Boatman, supra*, that petitioners

realized ordinary income in 1954 when they repossessed the real estate under a mutual agreement with their vendee that the contract of sale was not to be carried out and that they were to retain that part of the purchase price which had already been paid them.

The additions to tax under section 294(d) are not contested in the event a Rule 50 computation results in deficiencies. However, in view of the Supreme Court's decision in *Commissioner v. Acker*, ... U.S. .... (November 16, 1959) and the determination stating that no declarations were filed, the only additions to tax that would be proper are those under section 294(d) (1) (A), Internal Revenue Code of 1939.

Similarly, no issue has been raised with respect to the addition to tax under section 6651(a), Internal Revenue Code of 1954. Accordingly, it is sustained.

Because of concessions and stipulated adjustments,

Decisions will be entered under Rule 50.